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CITATIONS

245563—40——1

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

RECTOR & DAVIDSON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered in the above entitled cause on April 16, 1940.

OPINIONS BELOW

The unpublished memorandum opinion of the Board of Tax Appeals is printed in the record at pages 38 to 47, inclusive. The opinion of the Circuit Court of Appeals is reported in 111 F. (2d) 332.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 16, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the group associated together and doing business under the name of Rector and Davidson was, during the taxable years involved, an "association" within the meaning of Section 1111 (a) (2) of the Revenue Act of 1932 and Section 801 (a) (2) of the Revenue Act of 1934, and as such subject to income tax as a corporation during the years involved.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and regulations involved are printed in the Appendix, *infra,* pp. 14–23.

STATEMENT

Rector & Davidson, sometimes hereinafter referred to as the taxpayer, filed a Partnership Return of Income for the taxable years 1932, 1933, and 1934, disclaiming any liability for federal income tax. (R. 38, 136–150.) The Commissioner of Internal Revenue thereafter determined that during the years involved Rector & Davidson was doing business as an association within the meaning

of Sections 1111 (a) (2) of the Revenue Act of 1932 and 801 (a) (2) of the Revenue Act of 1934, and as such was subject to income tax as a corporation. He therefore asserted the deficiencies in income and excess profits taxes here in controversy (R. 12–14, 24–29, 38), and petitions for review were filed with the United States Board of Tax Appeals (R. 9–11, 14–16, 20–22, 31–34). The proceedings were submitted to the Board upon certain documentary evidence and oral testimony (R. 68–163) and the facts were summarized by the Board as follows (R. 39–46):

In February and March, 1931, four individuals, O. M. Rector, an oil operator, Robert Davidson, an insurance agent and farmer, Charles Hagins, operator of a planing mill, and J. R. Webb, engaged in the tombstone business, each purchased an undivided one-fourth interest in an oil and gas lease on 2⅝ acres of land known as the Brightwell Tract in Rusk County, Texas. The cash payment for such acquisition of that lease was made with money borrowed from the First State Bank of Corsicana, Texas, on a note signed by each of those four individuals. Such lease, which was for a term of five years and as long thereafter as oil, gas, or other mineral was produced from the leased premises, was taken in the name of J. R. Webb as lessee and reserved to the lessors a ⅛th royalty and certain royalties on gas and other minerals. The lease was signed and acknowledged by the proper parties and

duly recorded in the deed records of Rusk County, Texas. (R. 39.)

Since Rector was an experienced oil operator and Davidson had some knowledge of bookkeeping, the above named four individuals decided that the lease should be transferred to O. M. Rector and Robert Davidson, who should supervise the operation of the leased premises and keep the necessary accounts. Furthermore, since those four individuals were not financially able to develop the leased premises, they also decided to sell fractional interests in the lease to the extent of $\frac{1}{5}$th of their joint $\frac{7}{8}$ths working interest. (R. 39–40.)

On May 18, 1931, J. R. Webb duly executed and acknowledged an assignment of the full $\frac{7}{8}$ths interest in the above mentioned lease to O. M. Rector and Robert Davidson, their heirs, successors, and assigns, and such assignment was duly recorded. Rector, Davidson, Webb, and Hagins divided their joint interest in the lease into 360 fractional parts, each retained a $^{7}\frac{2}{360}$th interest, and, through personal solicitation of their friends and acquaintances in Corsicana, they sold a total of $^{7}\frac{2}{360}$ths fractional interests to 43 persons, for an undisclosed consideration for each $\frac{1}{360}$th interest. On May 23, 1931, there was executed an assignment of an undivided fractional interest in the lease to each of the 43 purchasers of such fractional interest, and each assignment, which also embodied a power

of attorney to Rector & Davidson, was made on the following form (R. 40–44):

> WHEREAS, O. M. Rector and Robert Davidson, operating as Rector and Davidson, are the owners of an oil, gas and mining lease covering the following described tract of land situated in Rusk County, Texas, to-wit:
>
> * * * * *
>
> NOW THEREFORE * * * the undersigned, the present owners of the said lease and all rights thereunder or incident thereto, do hereby bargain, sell, transfer, assign and convey unto ---------- an undivided ---------- interest in and to all of the right, title and interest of the lessee * * *.
>
> * * * * *
>
> 1. In consideration of the grantee, herein above named, purchasing this assignment and the leasehold property herein conveyed, Rector and Davidson hereby contract and agree to do the following things, to-wit:
>
> (a) To drill at their own cost and expense, one well on the lease above described; said well to be drilled to a depth of 3,800 feet unless granite in solid formation in its regular place is encountered at a lesser depth and in such quantities as to render it impenetrable; or unless oil or gas in paying quantities be encountered at a lesser depth.
>
> 2. In consideration for Rector and Davidson doing the things set out and stipulated in paragraph numbered "1" above and in subdivision "a" thereof, the owner and holder of this assignment agrees that Rector and

Davidson shall operate said lease above described for the benefit of all the parties interested in said lease; and shall collect for all pipe line runs of oil from said lease, and likewise, collect all money to be received from the sale of gas from said lease; and after having paid all proper operating expenses, shall distribute and pay to the owners of said lease, such proportion of the remaining proceeds as their respective interests in said lease shall entitle them to receive, according to the proportionate part of said lease they then own.

3. It is further agreed by the parties hereto that the undersigned Rector and Davidson shall have the power at any time, in their discretion, to sell and dispose of all or any part of the above described lease-hold property on such terms and conditions and at such price as in their judgment shall seem best and proper, and the said Rector and Davidson, as a part of this sale, hereby reserve the power and right to make such sale or sales of all or any part of said property, and to transfer, convey and assign the same, and as an incident thereunto, they shall execute and deliver all such written instruments as may be necessary or required to properly and legally convey and assign good title thereto, to the purchaser or purchasers thereof. And the said Rector and Davidson are, for the purpose of making such sale or sales, fully and completely authorized and empowered to sign the name of the grantee

herein to any and all instruments that may be necessary to be executed and in all other respects to act in said grantee's place and stead as said grantee's attorney in fact, executing, acting and delivering such written instruments and muniments of title the same as grantee could do if personally present and executing and delivering the same in person, and in accepting and buying this assignment, the grantee herein does so with the express understanding that the said Rector and Davidson, as above stipulated and provided, may act as attorney in fact for said grantee as above set out, the said grantee hereby ratifying and confirming all such lawful acts as the said Rector and Davidson shall do or cause to be done by virtue hereof. It is expressly understood and agreed, however, that when said lease-hold property or any part thereof shall have been sold as herein provided, the said Rector and Davidson shall receive and distribute to each of the parties owning an interest in said lease-hold property or any part thereof, such proportionate part of the net proceeds derived from said sale as each of said parties shall be entitled to receive, according to the interest each of the parties respectively owns in said lease-hold property or part thereof. It is further agreed by and between the grantor and grantee herein that this instrument is to be effective as an assignment, transfer and conveyance of the interest

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herein described only when signed and acknowledged by the grantor herein.

Rector and Davidson hereby reserve the right to pay all money due to the owner of the interest hereby assigned to the grantee herein unless they shall have received notice that the interest hereby assigned has been sold and assigned by the grantee herein to some other person. All subsequent assignees of the interest herein assigned shall take said interest subject to and be bound by the terms, covenants, agreements and reservations herein contained.

IN WITNESS WHEREOF, the undersigned owner and grantor has signed this instrument this _____ day of _____, A. D. 19_____.

RECTOR AND DAVIDSON,

By _____,

Grantors.

_____,

Grantee.

On May 1, 1933, Rector & Davidson, by written assignment duly acknowledged and executed, transferred to each J. R. Webb and Charles Hagins their 72/360ths interest in the lease. (R. 44.)

The use of the name "Rector & Davidson", as a firm or partnership name, arose out of acquisition of the leased premises by Rector, Davidson, Webb, and Hagins and their decision that Rector and Davidson should supervise the operation of the leased premises. That name of "Rector & David-

son" was not at any time used in connection with any other enterprise. The designation of "Rector and Davidson—Brightwell Lease Syndicate No. 1", appearing at the head of the assignments given to the purchasers of fractional interests, was merely for the purpose of identification of the project. In 1933 the following instrument was executed (R. 44–45):

O. M. Rector,	Instrument: Affidavit
et al	Dated: Feb. 7th, 1933
To	Filed: Feb. 9th, 1933, 11 AM
The Public	Recorded: Vol. 229, Page 577
# 843	Rusk County Deed Records.

RECTOR AND DAVIDSON, TO THE PUBLIC

This is to advise the public that the partnership of Rector and Davidson, in the Rusk County, Rector and Davidson-Brightwell Lease Syndicate No. 1 is composed of the following persons and interests at this date.

O. M. Rector, $^{72}/_{360}$ interest; Robert Davidson, $^{2}/_{360}$ interest; Harold M. Davidson, $^{70}/_{360}$ interest; J. R. Webb $^{72}/_{360}$ interest; Chas. Hagins, $^{72}/_{360}$ interest; and the remaining $^{72}/_{360}$ interest is owned in various sums and amounts by several persons by assignments on special form of assignment of oil and gas lease, said persons being known in said partnership as unit holders.

Witness our hands this 7th day of February, 1933.

O. M. RECTOR
ROBERT DAVIDSON

Rector, Davidson, Webb, and Hagins drilled and equipped the first well on the leased premises at their own expense. A second well was drilled in 1933 and paid for by *pro rata* contributions from all of the co-owners of fractional interests. The third well, which was drilled in 1934, was financed by the driller, Fred Upchurch, who, with the consent of all the fractional interest holders, was given a duly executed assignment, dated September 15, 1934, for a 1/6th interest in the entire leased premises. Thereafter, the denominator of fractional interests was changed to 432nds. (R. 45.)

During the taxable years in question O. M. Rector and Robert Davidson operated the leased premises, arranged for the sale of the oil produced therefrom, paid the expenses and distributed the net proceeds therefrom in accordance with their separate agreement with each purchaser of a fractional interest. Such operations were on behalf of all of the various co-owners of fractional interests in the leased premises. Rector supervised the operations and Davidson kept the accounts and performed various odd jobs and each of them received a salary for such services. The books of accounts, which showed the various interests owned, the oil runs, expenses, and all of the transactions with reference to the leased premises, were kept at Davidson's home. "Rector & Davidson" had no office, no seal, no minutes, and no stock books. (R. 45–46.)

All receipts from the pipe-line companies for oil purchased from the leased premises were deposited in a bank account captioned "Rector & Davidson" and the checks drawn thereon were signed "Rector & Davidson, By O. M. Rector", or, "By Robert Davidson", whichever drew the checks. Settlements were made with the interest holders every 30 days, after the payment of operating expenses which included the salaries paid to O. M. Rector and Robert Davidson. (R. 46.)

During the years in question the numerous owners of fractional interests in the leased premises were not issued any certificates or evidences of their interests other than the above mentioned assignments by Rector and Davidson in 1931 and subsequent conveyances which were made from time to time, during those years, by the individual owners of fractional interests. Such conveyances were made by duly executed assignments without the consent of other interest holders and without interrupting the operation of the leased premises by O. M. Rector and Robert Davidson. The co-owners of fractional interests never held any meetings and whenever they were consulted as to the operation of the lease, such as was done in connection with the drilling of the second and third wells, Rector and Davidson merely called on them personally. There was no limitation upon the personal liability of the various co-owners of undivided fractional interests in the lease. (R. 46.)

The Board concluded, on the basis of the foregoing statement, that Rector & Davidson was not doing business as an association during the taxable years involved within the meaning of the applicable revenue acts and that it was not taxable as a corporation. (R. 47.) The Circuit Court of Appeals affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the question whether Rector & Davidson was taxable as a corporation during the years involved is a question of fact, and in failing to hold that the question is a question of law.

2. In holding, on its assumption that the question is one of fact, that the Board of Tax Appeals found as a fact that Rector & Davidson was not an association taxable as a corporation for the years involved.

3. In holding, on its assumption that the question is one of fact, that the evidence supports the Board's finding that Rector & Davidson was not an association taxable as a corporation.

4. In failing to hold as a matter of law that Rector & Davidson was, during the years 1932, 1933, and 1934, doing business as an association as that term is used in Section 1111 (a) (2) of the Revenue Act of 1932, and Section 801 (a) (2) of the Revenue Act of 1934, and as such subject to the federal income tax imposed on corporations.

5. In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

The facts and issues in this case are substantially the same as those involved in *Helvering* v. *Horseshoe Lease Syndicate*, in which a petition for certiorari has been filed, No. 184, 1940 Term.[1] We respectfully refer the Court to our petition in the *Horseshoe Lease Syndicate* case for a statement of the reasons for granting the writ. Obviously, if certiorari is granted in that case, it should likewise be granted here.

CONCLUSION

Wherefore, it is respectfully submitted that this petition should be granted.

FRANCIS BIDDLE,
Solicitor General.

JULY, 1940.

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[1] The court below prefaced its statement of facts with the remark that "The facts in this case are very similar to the facts in *Commissioner of Internal Revenue* v. *Horseshoe Lease Syndicate*, decided by this court on March 26, 1940."

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 13. TAX ON CORPORATIONS.

(a) *Rate of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation, a tax of 13¾ per centum of the amount of the net income in excess of the credit against net income provided in section 26.

* * * * *

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.* — Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

* * * * *

SEC. 1111. DEFINITIONS.

(a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

(3) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this Act, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(8) The term "stock" includes the share in an association, joint-stock company, or insurance company.

(9) The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

* * * * *

(U. S. C., Title 26, Sec. 1696.)

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 13. TAX ON CORPORATIONS.

(a) *Rate of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation, a tax of 13¾ per centum of the amount of the net income in excess of the credit against net income provided in section 26.

* * * * *

(U. S. C., Title 26, Sec. 13.)

SEC. 52. CORPORATION RETURNS.

Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the

president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control. (U. S. C., Title 26, Sec. 52.)

SEC. 801. DEFINITIONS.

(a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

(3) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this Act, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(8) The term "stock" includes the share in an association, joint-stock company, or insurance company.

(9) The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

* * * * *

(U. S. C., Title 26, Sec. 1696.)

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 1311. *Person.*—The Act recognizes four classes of persons—individuals, trusts and estates, partnerships, and corporations. Corporations include associations, joint-stock companies, and insurance companies, but not partnerships properly so called. A taxpayer is any person subject to a tax imposed by the Act.

ART. 1312. *Association.*—Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in quasi-corporate form is an association or corporation within the meaning of section 1111.

ART. 1313. *Association distinguished from partnership.*—An organization, the membership interests in which are transferable and the business of which is conducted by

trustees or directors and officers without the active participation of all the members as such, is an association and not a partnership. The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of the Act, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization. Organizations which have a fixed capital stock divided into shares represented by certificates transferable only upon the books of the company, which manage their affairs by a board of directors or executive officers, and which conduct their business in the general form and mode of corporations are joint-stock companies or associations within the meaning of the Act even though under State law such organizations are technically partnerships.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 801–1. *Classification of taxables.*— For the purpose of taxation the Act makes its own classifications and prescribes its own standards of classification. Local law is of no importance in this connection. Thus a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See article 801–3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See article 801–4.) The term "corporation" is not lim-

ited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See articles 801–2 and 801–4.) The definitions, terms, and classifications, as set forth in section 801, shall have the same respective meaning and scope in these regulations.

ART. 801–2. *Association.*—The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Act, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

ART. 801–3. *Association distinguished from trust.*—The term "trust," as used in the Act, refers to an ordinary trust, namely, one cre-

ated by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association,

and the undertaking or arrangement is deemed to be an association classified by the Act as a corporation.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*.

The Act disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

ART. 801–4. *Partnerships.*—The Act provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Act, a trust, estate, or a corporation. On the other hand the Act classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed

period of its existence, and its management is centralized in one or more persons in their representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also articles 801–2 and 801–3. The following examples will illustrate some phases of these distinctions:

(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Act as a partnership.

(2) A, B, and C each contributes $10,000 for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.

ART. 801–5. *Limited partnership as corporation.*—Limited partnerships of the type of partnerships with limited liability or partnership associations authorized by the statutes of Pennsylvania and a few other States are only nominally partnerships. Such so-called limited partnerships, offering opportunity for limiting the liability of all the members, providing for the transferability of partnership shares, or having other material characteristics of corporate form, must make returns of income and pay the tax as corporations. In all doubtful cases limited partnerships will be treated as corporations unless they submit satisfactory proof that they are not in effect so organized. A Michigan partnership association is taxable as a corporation.

U. S. GOVERNMENT PRINTING OFFICE: 1940

No. 249

In the

UNITED STATES SUPREME COURT

October Term, 1940

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v.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

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BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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CITATION

CITATION—(Continued)

No. 249

In the

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October Term, 1940

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

RECTOR & DAVIDSON, *Respondent*

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BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

INTRODUCTION

On July 16, 1940, petition was filed on behalf of petitioner, praying that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered in the above entitled cause on April 16, 1940.

The respondent opposes the petition for writ of certiorari for reasons hereinafter set out.

OPINION BELOW

The unpublished memorandum opinion of the Board of Tax Appeals is printed in the record at pages 38 to 47, inclusive.

The decision of the United States Board of Tax Appeals is printed in the record at pages 48 and 49.

The opinion of the United States Circuit Court of Appeals is reported in 111 F. (2d) 332.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 16, 1940. The jurisdiction of this Court is invoked under *Section 240 (a) of the Judicial Code*, as amended by the *Act of February 13, 1925*.

Notice of filing the petition herein, together with notice that no brief in support will be filed, copies of petition and transcript of record were served on counsel for respondent on July 20, 1940.

QUESTION PRESENTED

The question presented is as follows:

For the calendar years 1932, 1933 and 1934, was respondent an associate within the meaning of Section 1111 (a) (2) of the Revenue Act of 1932 and see 801 (a) (2) of Revenue Act of 1934, and as such subject to income tax as a corporation?

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and regulations involved are set forth in the Appendix, infra, pages 10-19.

STATEMENT

The statement of facts set out on pages 2 to 13, inclusive, of the petition herein is essentially correct.

The Court below in its opinion made a concise finding of fact.

SUMMARY OF ARGUMENT

I.

THE DECISION BELOW IS CORRECT.

II.

THE DECISION BELOW IS NOT IN CONFICT WITH ANY DECISION IN ANY OTHER CIRCUIT AND IT DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT.

III.

THE QUESTION HERE PRESENTED REQUIRES THE APPLICATION OF PRINCIPLES AS DETERMINED BY DECISIONS OF THE COURTS TO THE FACTS IN EACH CASE TO BE CONSIDERED.

ARGUMENT

I.

The decision below is correct.

This Court has considered the association questions in *Hecht v. Malley, (44 S. Ct. 462, 265 U. S. 144); Morrissey v. Commissioner, (56 S. Ct. 289, 296 U. S. 344); Swanson v. Commissioner, (56 S. Ct. 283, 296 U. S. 362); Helvering v. Combs, (296 U. S. 365, 56 S. Ct. 287); Helvering v. Coleman-Gilbert Associates, (296 U. S. 369, 56 S. Ct. 285),* and has very definitely drawn the line of demarcation between associations, which due to their form of organization or methods of operation, are subject to tax as corporations and those which do not come within such scope.

Since all of these decisions have been rendered by this Court, it is not deemed necessary to quote its language at length.

The facts in the case under consideration are materially different.

(a) Rector & Davidson did not possess the attributes of a corporation.

(b) There is no continuity.

(c) There was personal liability.

(d) There were no shares or certificates of stated cash value issued.

(e) Rather, the interests sold were interests in realty as distinguished from personalty. Such interests were, in fact, interests in real estate, which under the laws of Texas, made the interest holders tenants in common.[1]

(f) By the instruments conveying the interests to the purchasers, Rector & Davidson were given power to act as attorney and agent of each joint owner. The use of such power in furthering the activities is not comparable to corporate activities.[2]

(g) The money derived from the saleo f undivided interests in the lease was used for its development, and not as a capital contribution as in the case of a corporation.

None of the characteristics of a corporation are, in any degree, similar to those of the respondent herein.

Rather, we have a relationship of principal and agent as discussed in the case of *A. A. Lewis & Company v. Commissioners, (57 S. Ct. 799).*

This case was decided subsequent to the *Morrissey case, supra,* and associated cases, and this Court differentiates between the salient facts in the case.

In this case, there was no trustee holding title for any one else, nor any form of legal entity.

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[1]Comm. v. Fleming, 82 F. (2d) 324, (C. C. A. 5th); McEntire v. Thomasson (Tex. Civ. App.), 210 S. W. 563.

[2]Comm. v. N. B.Whitcomb Coca-Cola Syndicate, 95 F. (2d) 596 (C. C. A. 5th) affg. 35 B. T. A. 1031.

Rather, it is the case where each interest holder was acting through his designated agent under power of attorney.

It is clear that the decision of the lower Court is correct.

II.

The decision below is not in conflict with any decision in any other circuit and it does not conflict with any decision of this Court.

It is contended that the decisions in the *Thrash Lease Trust case*, (*99 F. (2d) 925*), in which certiorari was denied, and in *Burk-Waggoner Oil Association v. Hopkins, (269 U. S. 110)*, are in direct conflict with the decision below in this case.

In the *Thrash Lease Trust case, supra*, the Board of Tax Appeals held that the petitioner had not presented facts sufficient to overcome the Commissioner's determination holding it to be an association.

It is contended in these and other cases cited by the petitioner that the facts are not similar to this case in that there was no resemblance to corporate activities, or separation of incident of ownership.

In the present case there was no legal entity separate and apart from the individual owner, but rather we have in the case under consideration individual ownership of interest in real estate acting through its agent.

This is directly comparable to the case of *N. B. Whitcomb Coca-Cola Syndicate, (95 F. (2d) 596)*, in which the Fifth Circuit Court of Appeals affirmed the decision of the Board of Tax Appeals.

It is contended that there is no conflict with any Circuit Court decision or decision of this Court.

III.

The question here presented requires the application of principles as determined by decisions of the courts to the facts in each case to be considered.

It is contended that this Court has set forth in the *Morrissey case, supra*, the proposition that "due to the variety of circumstances under which it may arise, no inelastic rule can be advanced to settle the question, but that the facts of each case must control its determination."

In its decision, the lower Court follows the test as presented in the *Morrissey* case, supra, and determines from the facts whether or not the respondent herein more closely resembles a partnership than a corporation.

Such test was followed by this Court in the case of *A. A. Lewis & Company v. Commissioner*, supra, and by the United States Circuit Court of Appeals for the Fifth Circuit in the *N. B. Whitcomb Coca-Cola Syndicate* case, supra, and in the case of *Bert v. Helvering, (92 F. (2d) 491)*, in which the principles of this Court have been followed.

The petitioner herein questions the decision of the Court below in passing upon the facts found by the Board of Tax Appeals that the respondent is not an association taxable as a corporation.

The Ninth Circuit in *Winnett et al. v. Helvering, (C. C. A. 9th) (68 F. (2d) 614), held that the finding of the Board of Tax Appeals that the cost of moving a house from a lot in a business district to one in a residential district is a capital expenditure, is a finding of ultimate fact, sufficient in law to support the Board's conclusion that the cost was not deductible as a business expense. The Court refused to interfere with the decision of the Board.*

It is contended that each case must be decided upon its own facts, and that the Board of Tax Appeals' findings in this case that the respondent did not come within the scope of an association taxable as a corporation was correct.

It is contended by the respondent that the necessity for review as contended in the petition would not serve any useful purpose in the administration of the statutes. There may be many organizations in which the association question shows itself, but as clearly pointed out by this Court in the *Morrissey* case, supra, it is a question of fact to be determined as to whether or not the facts in any particular case and methods of operation in each particular case so closely resemble a corporation as to make it taxable as such.

CONCLUSION

Since this Court in its decisions has clearly settled the question involved, and since there is no conflict with any other Circuit, it is, therefore, respectfully submitted that this case is not a proper one for review by certiorari in this Court, and that the petition for a writ of certiorari should be denied.

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August, 1940.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 13. TAX ON CORPORATIONS.

(a) *Rate of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation, a tax of 13¾ per centum of the amount of the net income in excess of the credit against net income provided in section 26.

* * * * *

SEC. 52. CORPORATION RETURN:.

(a) *Requirement.* — Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected from the corporations of whose business or property they have custody and control.

* * * * *

SEC. 1111. DEFINITIONS.

(a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

(3) The term "partnership" includes a syndicate, group, pool, joint venture, or other incorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this Act, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(8) The term "stock" includes the share in an association, joint-stock company, or insurance company.

(9) The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

* * * * *

(U. S. C., Title 26, Sec. 1696.)

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 13. TAX ON CORPORATIONS.

(a) *Rate of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation, a tax of 13¾ per centum of the amount of the net income in excess of the credit against net income provided in section 26.

* * * * *

(U. S. C., Title 26, Sec. 13.)

SEC. 52. CORPORATION RETURNS.

Every corporation subject to taxation under this title shall make a return, stating specifically the

items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

SEC. 801. DEFINITIONS.

(a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

(3) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this Act, a trust or estate or a corporation and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(8) The term "stock" includes the share in an association, joint-stock company, or insurance company.

(9) The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

* * * * *

(U. S. C., Title 26, Sec. 1969.)

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 1311. *Person.*—The Act recognizes four classes of persons—individuals, trusts and estates, partnerships, and corporations. Corporations include associations, joint-stock companies, and insurance companies, but not partnerships properly so called. A taxpayer is any person subject to a tax imposed by the Act.

ART. 1312. *Association.*—Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in quasi-corporate form is an association or corporation within the meaning of section 1111.

ART. 1313. *Association distinguished from partnership.*—An organization, the membership interests in which are transferable and the business of which is conducted by trustees or directors and offi-

cers without the active participation of all the members as such, is an association and not a partnership. The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of the Act a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization. Organizations which have a fixed capital stock divided into shares represented by certificates transferable only upon the books of the company, which manage their affairs by a board of directors or executive officers, and which conduct their business in the general form and mode of corporations are joint-stock companies or associations within the meaning of the Act even though under State law such organizations are technically partnerships.

Treasury Regulation 86, promulgated under the Revenue Act of 1934:

ART. 801-1. *Classification of taxables.*—For the purpose of taxation the Act makes its own classifications and prescribes its own standards of classification. Local law is of no importance in thic connection. Thus a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See article 801-3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See article 801-4.) The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an

association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See articles 801-2 and 801-4.) The definitions, terms, and classifications, as set forth in section 801, shall have the same respective meaning and scope in these regulations.

ART. 801-2. *Association.*—The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Act, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

ART. 801-3. *Association distinguished from trust.* —The term "trust," as used in the Act, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the

purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Act as a corporation.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Act disregards the technical distinction between a trust agreement (or declaration) and ordinarily articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true

whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

ART. 801-4. *Partnerships.*—The Act provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not within the meaning of the Act, a trust, estate, or a corporation. On the other hand the Act classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or more persons in their representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also articles 801-2 and 801-3. The following exam-

ples will illustrate some phases of these distinctions:

(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Act as a partnership.

(2) A, B, and C each contribute $10,000 for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.